Significant Index No. 4980.00-00 and No. 4980.01-00

TAX EXEMPT AND
GOVERNMENT ENTITIES

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200221049

FEB 25 2002

T:EP:RA:2

Legend:

Company A:

Plan X:

Plan Y:

This is in response to your ruling request dated May 12, 1999, as modified by your letter dated December 4, 2001. You seek a ruling on behalf of Company A, for whom you are the authorized representative, concerning the tax aspects of a proposed termination of Plan X with a certain portion of the excess assets of Plan X being transferred to Plan Y.

FACTS

Company A, a based in the State of sponsors Plan X and Plan Y for over 1,000 of its (and its subsidiaries') employees located throughout the United States.

Plan X, a defined benefit plan, was established January 1, 1958 to provide retirement benefits for most of its employees (and those of its subsidiaries) not covered by a collective bargaining agreement. The most recent favorable determination letter from the Service that Plan X was qualified under the Internal Revenue Code (the "Code") was dated September 12, 1996.

Plan Y, a defined contribution plan of the "401(k) profit-sharing" type, was established July 1, 1993 to provide both employer discretionary profit-sharing contributions and employee discretionary contributions, the latter being matched by the employer on a 25 percent basis for contributions up to six percent of the employee's wages. The active participants in Plan X and Plan Y are otherwise identical, except that Plan Y also provides limited benefits to members of a collective bargaining group. Plan Y has also been accorded qualified status since its inception.

When Plan Y was established, Plan X was concurrently amended to permit each participant in Plan X to make a one-time "roll over" of the lump sum value of his/her accrued benefit to become an initial account balance in Plan Y, and the amended Plan X was restructured as a "floor plan" providing each participant with the greater of (a) the accrued benefits under Plan X just prior to the amendment or (b) the benefits provided by Plan Y. You have stated that almost all of the active participants in Plan X elected at that time to roll over into Plan Y the present values of their accrued benefits under Plan X.

In the years since the establishment of the floor-offset arrangement, in almost every case the account balance in Plan Y has grown so rapidly that it now exceeds the value of the accrued benefits under Plan X. Company A, as sponsor of both these plans, therefore proposes (1) to terminate Plan X, and (2) after payment of all remaining accrued benefits thereunder, to transfer all excess assets in Plan X to an "Employer Account" set up in Plan Y to be used as a source of funds for future discretionary contributions as well as matching contributions to Plan Y.

It is estimated that at the present time the value of the accrued benefits in Plan X is approximately $4 million, whereas the value of the assets of Plan X is approximately $12 million. Company A proposes to transfer to Plan Y 25 percent of the "overfunding" now in Plan X.

This to be accomplished by the following steps:

First, freeze the benefits in Plan X at the time approval from the Service is obtained for the ruling request herein described. All Plan X participants would then become 100 percent vested in their Plan X benefits as well as 100 percent vested in their Plan Y employer discretionary contribution accounts.

Second, terminate Plan X. All accrued benefits under Plan X would, at the election of the participants, be either (1) distributed to the participants (either in the form of lump sum payments or as annuity contracts), or (2) made available to participants for roll-over to IRA accounts, or (3) rolled over into Plan Y.

Third, a separate determination (not a part of the ruling in this letter) will be requested from the Service on the qualification of Plan X upon termination.

Fourth, Plan Y will be amended to provide for a suspense account (the "Employer Account") into which would be distributed 25 percent of the residual assets of Plan X (as described above) and which, together with income credited thereto, would thereafter be available to satisfy discretionary contributions and/or employer matching contributions for Plan Y.

The proposed amendment to Plan Y requires that the assets in the Employer Account, together with all income credited thereto, should be allocated to the accounts of participants in Plan Y. Furthermore, such allocation would (1) be made even it exceeds the discretionary and matching employer contributions to Plan Y, (2) occur during the Plan Year in which the transfer takes place and the subsequent six plan years of Plan Y, and (3) be no less rapid than ratably over this seven-year period. The proposed amendment also provides for allocations to be coordinated with the limitations under Code section 415, as required under section 4980(d)(2)(C)(ii).

RULINGS REQUESTED

On the basis of the above factual representations, the following rulings are requested:

1. Twenty-five percent of the excess assets transferred from Plan X to the Employer Account in Plan Y will not be includible in the gross income of Company A and will not result in an income tax deduction.

2. The transfer of 25 percent of the excess assets of Plan X to the Employer Account in Plan Y will not be treated as an employer reversion under Code section 4980 and will not be subject to any excise tax under section 4980.

3. The transfer of 75 percent of the excess assets of Plan X to Company A will be treated as an employer reversion under Code section 4980, will be subject to a 20 percent excise tax under section 4980(a), and will be includible in the gross income of Company A.

LAW

Section 4980 of the Internal Revenue Code provides rules for the tax applicable on the reversion of qualified plan assets to an employer. Section 4980(a) of the Code provides for the imposition of a 20 percent tax on the amount of any employer reversion from a qualified plan. Section 4980(b) provides that the tax under section 4980(a) is to be paid by the employer maintaining the plan.

Section 4980(d) of the Code provides, in part, that the 20 percent tax (of Code section 4980(a)) is increased to a 50 percent tax unless (A) the employer establishes or maintains a qualified replacement plan, or (B) the plan provides benefit increases meeting the requirements of section 4980(d)(3).

Section 4980(d)(2) of the Code sets forth the requirements that must be met for an employer to establish or maintain a qualified replacement plan. There are three requirements, generally described as follows:

(1) At least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan.

(2) A direct transfer from the terminated plan to the replacement plan is made before any employer reversion, and the amount of such transfer is in an

amount equal to the excess (if any) of (A) 25 percent of the maximum amount the employer could receive as an employer reversion without regard to section 4980(d), over (B) an amount equal to the present value of the aggregate increases in the accrued benefits under the terminated plan of any participants or beneficiaries pursuant to a plan amendment that is adopted during the 60-day period ending on the date of termination and that takes effect immediately on the termination date.

(3) The amount transferred is allocated to the accounts of participants in the replacement plan or credited to a suspense account and allocated from such account no less rapidly than ratably over the 7-year period beginning with the year of the transfer. Additionally, the allocations are to be coordinated with the limitations under Code section 415 that may apply to certain participants.

ANALYSIS

First, we consider whether Plan Y is a "qualified replacement plan" within the meaning of Code section 4980(d)(2). Since all of the participants in Plan X, even before it is amended as described above, are already participants in Plan Y and would remain so as stated under the first step in the proposed transaction as described above, the participation requirement (the first condition under Code section 4980(d)(2)) is satisfied.

The asset transfer requirement (the second condition under Code section 4980(d)(2)) also is satisfied since an amount equal to 25 percent of the excess assets in Plan X (i.e., the excess assets after withdrawal of such funds as would be necessary to provide for the accrued benefits of existing participants) is to be directly transferred to Plan Y.

The amount to be transferred from Plan X will be credited to a suspense account (the Employer Account) in Plan Y for allocation to participants' accounts in Plan Y with the balance to be allocated at least ratably over a 7-year period, and such allocations are to be coordinated with the limitations of Code section 415 as they may apply to certain participants. This satisfies the allocation requirement (the third condition under Code section 4980(d)(2)).

CONCLUSIONS

1. We conclude that Plan Y is a qualified replacement plan. Therefore, following Code section 4980(d)(2)(B)(iii), with respect to the first ruling request we further conclude that 25 percent of the excess assets transferred from Plan X to the Employer Account in Plan Y will not be includible in the gross income of Company A, nor will any deduction be allowable with respect to such transfer.

2. With respect to the second ruling request, we conclude that, based on the information and circumstances described above, the transfer of 25 percent of the excess assets of Plan X will not be treated as an employer reversion under Code section 4980 and will not be subject to any excise tax under section 4980.

3. With respect to the third ruling request, we conclude that the remaining 75 percent of excess assets transferred from Plan X to Company A will be treated as an employer reversion under Code section 4980, will be subject to a 20 percent excise tax under section 4980(a), and will be includible in the gross income of Company A.

This letter is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have questions, please call (not a toll-free number). In any correspondence relating to this letter, please refer to as well.

Sincerely yours,

Martin L. Pippins

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Employee Plans Actuarial Group 2